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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 8

CRANE-JOHNSON COMPANY, a corporation of North Dakota,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

REPLY BRIEF FOR PETITIONER.

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The Court will take judicial notice of such a matter of common knowledge as that a corporation issues stock certificates. In any event respondent's argument that the question whether a stock certificate is a contract was not properly raised below, cannot avail it on the general question before the Court because the decision in the *North-*

west Steel Rolling Mills case, argued herewith, was in favor of that taxpayer and that taxpayer is entitled to sustain that decision by any argument it can advance to show that decision was right and it does advance the argument that the stock certificate is a contract (Petitioner's Brief therein, p. 43). Indeed, respondent concedes on page 36 of his brief in the case at bar that the stock certificate is a contract. See also *Bedford* v. *Eastern Building & Loan Association,* 181 U. S. 241. He cannot deny that the North Dakota Corporation law which expressly deals with the payment of dividends is a provision of this stock certificate contract exactly as if recopied therein, (*Walker* v. *Whitehead,* 16 Wall. 314 and *Edwards* v. *Kearzey,* 96 U. S. 601). On page 18 of his brief he expressly concedes this.

This concession forces him, as a last resort, to the argument that the income tax statute here involved should be read as if it required "a provision expressly written into a contract and not one that is implied." Such are not the words of the statute. Certainly the plain words of the statute cannot be thus distorted and altered without ignoring all the applicable rules of statutory construction set forth in our main brief nor can the words of the statute be so distorted without ignoring entirely the intention of Congress and especially the situation which it sought to relieve by the relief provision now before the Court. No more need be said to entitle petitioner to prevail.

On page 6 of his brief respondent argues that the statute should be read as if it required "a provision expressly written into the contract and not one that is implied." At the bottom of page 19 and the top of page 20 of his brief respondent repeats this argument. The trouble with this argument is that the statute does not read the way

respondent would have it read. Also it wholly disregards the fact that the taxpayer is in the identical situation in both cases. We make the point that respondent's argument adds something to the words of the statute which are not there. The plain words of the statute are "a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends." Under these words it matters not whether the provision be express or implied. Why should it matter?

Congress did not make the statute read "a provision expressly written into the contract and not one that is implied," as respondent on pages 19 and 20 of his brief argues it should read, and the statute cannot be made to so read without amending it to change its wording. This is not within the judicial power.

It has long been settled that what is implied in the Constitution is as much a part of it as that which is expressed (*Yarborough,* 110 U. S. 658) and what is implied is as much a provision of a contract as what is expressed. Contracts, 12 American Jurisprudence, Sec. 239, p. 765; 17 C. J. S., Sec. 328, p. 778. This is equally true whether the contract be written or oral. It is elementary that the statutory law applicable to it is a part of every written contract. 12 American Jurisprudence, Sec. 240, p. 769; 17 C. J. S., Sec. 330, p. 782. The lawyers on the Conference Committee knew the charter included the state corporation law and constituted a written contract.

Respondent contends our premise that a corporate charter is a written "contract" is unrealistic solely because

he alleges in normal parlance the unqualified statutory term "contract" does not embrace a corporate charter. With that we take sharp and emphatic issue. This same rule of statutory construction which requires words to be taken in their natural and ordinary meaning in common speech is applicable also in the construction of the Constitution. *Pollock* v. *Farmers Loan & Trust Co.*, 158 U. S., 618. If the unqualified word "contract" when used in the Constitution embraces a corporate charter then there seems no escape from the conclusion it must also embrace a corporate charter when used in a statute—no contrary intent clearly appearing. Especially when it appears in a statute written by a Conference Committee composed of excellent lawyers to whom the then ancient and repeatedly and unanimously followed decision in the *Dartmouth College case* was an elementary part of common knowledge.

Judicial notice will be taken that nearly all members of the Congress enacting this law were lawyers and those not lawyers were familiar with the decision in the *Dartmouth College case* holding a corporate charter to be a contract. It is a rule of statutory construction that where a word used in a law has previously been construed by the Courts and has acquired a settled significance the word is presumed to have been used by Congress in that sense unless a contrary intent clearly and unquestionably appears. *Heald* v. *District of Columbia*, 254 U. S. 20, 23. No such intent appears here. Instead of such contrary intent appearing it cannot be denied by anyone that a corporate charter is embraced within the spirit of the statute. By the above rule of construction it is also embraced within its letter. To so hold is to carry out the just endeavor of Congress not to penalize cor-

porations for failing to do something that could not be done.

With reference to a statute being a contract, this Court said in *New Jersey* v. *Yard,* 95 U. S. 114:

> "The greatest trouble we have had on this point has been in regard to what may be called legislative contracts—contracts found in statute laws of the State, if they existed at all. It has become the established law of this court that a legislative enactment in the ordinary form of a statute, may contain provision which, when accepted as the basis of action by individuals or corporations, become contracts between them and the State within the protection of the clause referred to, of the Federal Constitution."

Respondent, ignoring the exact and accurate point involved here that the statute is a provision of the charter contract, tries to substitute the straw man general question of whether statutes are contracts and having set up his straw man argues to demolish him that if Congress "had this intention, it would have been a simple matter for it to have said so." We say that if Congress had any intention of excluding a corporate charter from the unqualified statutory term contract and of modifying the elementary principles of law and common knowledge on which we rely it would have been a simple matter to have said so and it would have said so. Not having excluded it and in view of the common understanding of all lawyers that a corporate charter is a contract the unqualified statutory term "contract" must be deemed to include a corporate charter. Congress must certainly be deemed to have known this elementary principle and legislated with knowledge of it.

At the bottom of page 21 of his brief and at page 45 thereof respondent argues that to hold a corporate char-

ter to be a contract would place "an intolerable burden" on the Bureau of Internal Revenue. This is an argument which we submit is without basis. How about the burden on almost bankrupt taxpayers who must pay if respondent is upheld? None of the debates in Congress lend any support to it, nor does any other part of the legislative history of the act show such an idea was even suggested. Respondent happened to think of it in his desperate groping for something to advance in argument.

As stated in Congress there are thirty-six states which prohibit deficit corporations declaring dividends. Certainly the other twelve give no trouble. At the bottom of page 50 of his brief respondent concedes the great weight of authority in these thirty-six states is that a corporation may not declare a dividend unless it has a surplus. The annual corporation income tax returns, the capital stock tax returns, as well as estate tax returns making essential the valuing of corporate stock—all of which are in the files of the Bureau, disclose whether a corporation has a surplus or a deficit. This is already known to the Internal Revenue Bureau. Each year its agents have audited corporations' books. There is no recorded tax decision where any difficulty has been encountered in determining whether a corporation's capital is impaired. The problem is no different than the problem of valuation for tax purposes which is inseparable from many other provisions of tax laws. As to the need to consult state law this cannot be avoided in tax cases. *Cf. Helvering* v. *Fuller,* 310 U. S. 69.

On page 23 of his brief respondent quotes this Court that the income tax statutes "in the absence of language evidencing a different purpose should be interpreted so as to give uniform application to a nation-wide scheme of

taxation." We invoke this point at pages 44 and 45 of our main brief and show how it supports our contention. What respondent here asks the Court to do is to so construe the statute that deficit corporations in twelve states have an election to avoid the tax while those existing in the other thirty-six states have no such election. This construction will not produce but will destroy uniformity for other reasons. (Also see pp. 44 and 45 of our main brief.) On the other hand the construction for which we contend will produce uniformity and not discriminate against the poor struggling corporation in favor of the rich one.

We also take sharp issue with the argument of respondent that Congress deliberately omitted a provision giving relief to deficit corporations in order to tax them. The legislative history shows a contrary intention. The House bill granted them all relief. This shows the House did not want to tax them. The Senate hearings at page 282, show that one Alvord testified it would be a hardship to impose a tax on deficit corporations. Senator Barkley asked him what remedy the Senate should adopt for that situation. Alvord suggested a flat rate of tax. The Senate adopted his suggestion in its bill which the Conference Committee later rejected and rewrote.

The Senate bill according to the statement of the Committee Report set forth on page 39 of our main brief desired to avoid "doing the injustices above described." At page 5 of this same Senate Committee Report one of the "injustices above described" was stated thus:

> "The plan penalizes small corporations and corporations with insufficient reserves and is of decided advantage to the large corporation and the corporation with excessive surplus."

Notwithstanding the Senate Committee stated it did not desire to do the above described injustice, nevertheless respondent would have this Court hold it did and argues that it omitted the provision of the House bill relieving all deficit corporations, because it intended to tax all of them.

Furthermore the legislative history set forth on page 33 of respondent's brief shows that as soon as the unwarranted administrative construction which we contest in this case was called to its attention Congress rebelled against and corrected it. This is inconsistent with respondent's contention that this administrative construction was in accord with what Congress previously "deliberately" intended. Instead of supporting respondent this action of Congress supports petitioner.

As shown on page 37 of our main brief the authors and proponents of the Conference bill stated corporations such as petitioner were not taxed by it.

On page 19 of his brief respondent claims that to construe the word "executed" to mean "made" renders the word superfluous. We are utterly unable to follow this reasoning. Under our contention the statute would read exactly the same whether Congress had used the word "executed" or the word "made." Nor can we follow the argument on page 21 adopted by the Court below that 26 (c) (2) deals with a situation at all similar to 26 (c) (1). The two situations are different except that in both cases the corporation is unable to pay the earnings in dividends. Section 26 (c) (2) shows Congress was trying to extend and make more comprehensive its relief.

It seems plain to us that the House Report, quoted on page 25 of respondent's brief, shows Section 15 was de-

signed to take care of corporations existing in the 36 states where deficit corporations were prohibited from paying dividends and that Section 14 was included to take care of the deficit corporations existing in the other 12 states where they were not so prohibited. These corporations, however, did not imperatively need this relief and that alone justified the omission of Section 14 from the Senate bill. They had an option to avoid the tax but deficit corporations in the other 36 states did not have this option.

It seems obvious to us that the change in the definition of a dividend by the Senate bill, stressed at the bottom of page 28 to page 30 of respondent's brief could only have related to corporations existing in the 12 states where they could legally declare dividends. To assert that it related to those of the other 36 states is to impute to Congress an intention that corporations in these 36 states might be induced to violate state law and would violate it.

Whether a return of capital can ever be made taxable income by law is at least a debatable question. Certainly if your Honor has invested $50,000 in a corporation which proceeds to lose $25,000 and you only recover $25,000 of your original investment, it would seem such $25,000 cannot be made a taxable dividend. If it is not a taxable dividend then there is no dividend paid credit by virtue of another provision of the law. *Centennnial Oil Co.* v. *Thomas,* 109 F. (2d) 359; cer. den. 310 U. S. .....

On page 30 respondent shows Senator Walsh did not think the contract provision relieved deficit corporations forbidden by law to declare dividends. We agree that Senator Walsh did not think so. Our point is that he stated the proponents of the bill thought so. His state-

ment cannot, as respondent asserts, be taken to allude to the general provisions of Section 14 (c) discussed at the bottom of page 31 of respondent's brief. This provision applied to all corporations and there is nothing to indicate that anyone had corporations forbidden by law to declare dividends in mind in connection with it. Certainly it is more persuasive from the standpoint of legislative history to show what the proponents and drafters of the bill thought it did than what its opponents thought. It is well known that opponents of a bill are likely to allege almost anything they think might help to defeat it.

On page 36 of respondent's brief and again in note 7 on page 28 the impression is given that petitioner herein raised the issue that the stock certificate was a contract for the first time in a petition for rehearing. Inasmuch as respondent states petitioner's reply brief has been filed with this Court we submit that a reading of pages 6 and 7 of that brief will show how clearly and squarely the issue was raised in the court below. It was also emphasized in oral argument in that court and in the petition for certiorari. However the issue is squarely before the Court in the companion *Northwest Steel Rolling Mills case*, argued herewith. Also when laymen are allowed to practice before an administrative board the old technicalities of the common law clustered about appeals ought to give way in appeals from that board.

With reference to the argument that petitioner made "no express agreement that its directors would not distribute dividends except in accordance with state law" we think it did but answer that the provision of the income tax law here involved does not require an express agreement but only a provision of a written contract (regardless whether express or implied) which provision ex-

pressly deals with the payment of dividends. Respondent seems to concede on page 37 of his brief that "such an agreement is implied by law." This being so his case fails. Not only the letter but the reason of the law dictates relief in both cases because an implied provision expressly dealing with the payment of dividends places a corporation in the same position as an express provision of a contract.

In his constitutional argument respondent seems to rely on *Helvering* v. *National Grocery Co.*, 304 U. S. 282. That case is not in point for two reasons. First the tax in that case was imposed because of failure to do a lawful act. Secondly, the tax there was plainly necessary to prevent evasion of the individual income tax. A tax on deficit corporations would not prevent such evasion. In this connection it is interesting to note that all the cases collected in note 4 on page 15 of respondent's brief are all cases of struggling corporations and each involves a few hundred dollars in income tax. These are typical of the overwhelming majority of deficit corporation cases.

At pages 47 to 54 of his brief respondent argues petitioner has not sustained the burden of proving it was prohibited by state law from distributing dividends. When reference was made to a "deficit" corporation in the legislative history of this provision of the law whether in the debates, in the Committee Reports or in the proposed bills it referred to only one thing—a corporation with an impairment of capital stock. It means that in accounting. The stipulation entered into between the attorney for the Government and the Certified Public Accountant who represented the petititoner before the Board of Tax Appeals states in plain terms (R. 12) that "as of January 1, 1936, the petititoner had a deficit of at least $21,251.40." The

Board found the fact as stipulated. If it had a deficit it did not have a surplus. If it had no surplus it could not declare a dividend under the North Dakota statute. The rule set forth at the top of page 50 of respondent's brief and there alleged to prevail in a few states and conceded by respondent at the bottom of page 50 not to prevail in the overwhelming majority of states is not the rule in North Dakota, as the quotation from the Supreme Court of that state together with the authorities cited by it set forth on page 15 of our main brief shows. These authorities which the Supreme Court of North Dakota cites are in accord with the majority rule.

The statement that the stipulation is based on the book figure, at the bottom of page 51 and at the top of page 52 of respondent's brief, is an inference instead of a flatly stipulated fact. However, even if it was based on the book figure the rule in tax cases is that the book figures are *prima facie* correct and stand as *prima facie* proof and in the absence of a contrary showing prevail.

All of which is respectfully submitted.

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